No. 10,253

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

SECTION SEVEN CORP. (a corporation),
Appellant,

vs.

CLIFFORD C. ANGLIM, Collector of Internal Revenue for the First District of California,
Appellee.

APPELLANT'S REPLY BRIEF.

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Table of Authorities Cited

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Appellee concedes that it is established law that a corporation which leases all of its property for a long term and surrenders all control of its property to the tenant and merely collects and distributes rentals, *IS NOT* doing business and hence is not taxable under I. R. C. 1200. He concedes, by failure to dispute the point, that the test as to whether or not a corporation is subject to the declared value excess profits tax imposed by Section 1200 of the Revenue Code, is whether or not it is *in fact* carrying on or doing business and *not* whether it has the *power* to conduct business. He concedes that appellant's activities during the taxable year were not great but urges that the terms of the

oil lease, Exhibit 1, conferred certain rights upon appellant, that appellant must have seen to it that the conditions of the lease were met, and that it therefore engaged in business. Appellee then cites the cases of *U. S. v. Trust #B-1,* 107 Fed. (2d) 22, and *Kettleman Hills Royalty Syndicate #1 v. Commissioner,* 116 Fed. (2d) 382, in support of his argument, but he does not state, as he did in the lower Court, that these cases are controlling here.

Although the lease, Appellant's Exhibit 1, contains many provisions for the protection of appellant and confers upon the appellant power to do a number of things, there is no evidence in the record that appellant did any of these things. All leases contain provisions protecting the lessor but the *mere existence of these provisions* does not *ipso facto* constitute the act of carrying on or doing business. Appellee confuses the power to carry on or do business with the actual doing of business.

Reduced to essentials, appellant's argument is that a corporation, owning a single piece of oil property, which it has leased under the terms and provisions of the ordinary and usual oil lease, carries on or engages in business by virtue of the existence of the lease regardless of any act done or performed by it under the terms of the lease.

We most respectfully submit that such is not the law.

The activities of appellant hereunder come squarely under the provisions of Treasury Regulation #64, 1938 Edition, Article 43-b-1 (set forth on pages 4 and 5 of Appellee's Brief). Appellant has reduced its ac-

tivities to the mere ownership and holding of the property and the distribution of its avails and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs.

Therefore, under the law and the regulations, appellant is *not* carrying on or doing business.

On page 9 of his brief, appellee correctly states that for the taxable period ending June 30, 1939, taxpayer's total income was $29,431.64 and its total expenses $10,092.36.

These figures without an explanation are misleading. Of the total expenses of $10,092.36, $8,198.38 represented taxes paid; and expenditures other than taxes are as follows:

		$ 8,198.38
Accountant's fees	$ 460.75	
Attorneys' fees	1,372.50	
Miscellaneous office expense	25.08	
Stationery and office supplies	12.62	
Telegraph and telephone	23.03	1,893.98
		$10,092.36

(R. 53.)

The case of *U. S. v. Hercules Mining Company,* 119 Fed. (2d) 288, cited by appellee on page 10 of his brief, although deciding that the corporation in question was subject to the capital stock tax on the ground that it was carrying on or doing business, involved an entirely different set of facts than the case at bar. Hercules Mining Company had been engaged for many years in

operating a mine and running a mill and concentration plant. The mine and mill were temporarily shut down, but the corporation was engaged in activities in connection with its property looking toward the resumption of mining and milling. The evidence showed that milling was resumed shortly subsequent to the termination of the taxable year in question.

In the case of *Magruder v. Washington B. & A. Realty Corp.,* 316 U. S. 69, a corporation had been formed to liquidate certain terminal properties which had been acquired by bondholders upon foreclosure. The corporation had leased certain of its properties on short term leases and had sold off certain other properties. The question presented was whether or not a corporation engaged in liquidating was carrying on or doing business. The Supreme Court of the United States held that it was so engaged and that the provisions of Article 43-a-5 exactly fitted the situation. The cited case is not in point.

It is respectfully submitted that the judgment herein should be reversed with instructions to the District Court to enter judgment for plaintiff as prayed.

Dated, San Francisco,
December 16, 1942.

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Louis H. Brownstone,
Attorneys for Appellant.